

### 33. REGULATION: COSTS AND BENEFITS

Along with taxing and spending, the Federal Government makes policy through regulating—that is, generally, through Executive Branch actions to interpret or implement legislation. The Administration's approach to regulation is careful design and implementation at the least cost. The Office of Management and Budget (OMB), the White House office that sets regulatory policy, has adopted the following objective in its Strategic Plan: maximize social benefits of regulation while minimizing the costs and burdens of regulation.

The Government is still learning how to accurately estimate regulatory costs, such as how much the private sector spends to comply with regulations, and benefits, such as safer cars and food. For more than 20 years, a series of Executive Orders has charged OMB with reviewing regulations and providing information on their costs and benefits. The President's September 1993 Executive Order, "Regulatory Planning and Review," directs agencies to assess the costs and benefits of available regulatory alternatives and to issue only regulations that maximize net benefits (benefits minus costs), unless a law requires another approach.

Developing and evaluating the best possible data on benefits and costs are central to the Government's ability to assess how well the regulatory system functions to fulfill public needs. To meet that goal, OMB works with the agencies to improve the quality of the data and analyses they use in making regulatory decisions for both new and existing regulations, and to promote the use of standardized assumptions and methodologies uniformly across regulatory programs.

**Difficulties in Estimation:** Estimating regulatory costs and benefits is hard for a variety of reasons, two of the most important of which are the "baseline" problem and the "apples and oranges" problem.

To estimate how regulations affect society and the economy, the Government must determine the baseline against which to measure

costs and benefits; that is, what would have happened if the Government had not issued the regulation? But, several problems arise. First, no one can craft such a hypothetical baseline with certainty. Second, measures of costs and benefits often vary, depending on who is measuring. Agencies generally support their regulatory programs and, thus, may understate costs or overstate the likely benefits; at the same time, businesses and others who bear the costs will likely do the opposite. Third, the timing of estimates also may make a difference. Most estimates are made before the regulation takes effect, but evidence exists that once regulations are in place, the affected entities find less costly ways to comply.

The "apples and oranges" problem derives from the nature and diversity of regulation itself. Over 60 Federal agencies regulate over 4,000 times a year for a wide array of public purposes. OMB itself reviews about 500 proposed and final rules per year. The Government must make decisions about the chemicals introduced into commerce, the accessibility of public transportation, and safety of the Nation's food supply. Estimating the costs of such diverse activities is hard; estimating the benefits is even harder. The Government is working on these problems and is making steady progress on methodology and data collection.

**Costs and Benefits of Regulation:** OMB's second survey, *Report to Congress on the Costs and Benefits of Federal Regulations, 1998*, presents new estimates of the aggregate costs and benefits of Federal regulation and regulatory programs, as well as the costs and benefits of major individual regulations issued during the last three last years. The report continues progress toward developing a system to track OMB performance in minimizing costs while achieving social benefits.

The report uses information on costs and benefits published in peer-reviewed journals, or published for public comment by agencies and reviewed by OMB, to estimate aggregate

costs and benefits for four categories of social regulation: environmental, transportation, labor, and other social regulations, such as food safety (see Table 33-1).

The estimates in Table 33-1 are presented in wide ranges to emphasize their inherent uncertainty, particularly with the benefit estimates. Moreover, only costs and benefits that could be quantified and assigned a dollar value are included in the estimates. The estimates indicate that regulation has most likely produced very large net benefits for society, especially for the environment and transportation. The benefits of environmental regulations reflect the value that society places on improved health, recreational opportunities, quality of life, preservation of ecosystems, biodiversity, and so on. The broadening of the upper end of the range in the benefit estimates for the environment is largely due to an Environmental Protection Agency (EPA) report that, due to a court-ordered deadline did not go through an interagency review, and which estimates that the annual benefits of the Clean Air Act might be as high as \$3.2 trillion. The OMB report discusses the key assumptions behind these estimates and specifically notes that the results appear to be sensitive to choices made concerning the baseline for the analysis and the translation of improvements in air quality to human health benefits.

The benefits of transportation, labor, and other social regulation mainly include the value provided by improved safety and health. Generally, the costs are the expenses incurred

in compliance, based on engineering designs and current prices, although sometimes they properly include the opportunity costs of foregoing the benefits of what would have been produced in the absence of the regulation.

Although Table 33-1 shows that, in total and for important categories, Federal regulations have provided more benefits than costs, it says little about current regulatory policy or how to improve it. To address these issues, the Government needs estimates of the costs and benefits of the incremental changes to recent regulations. In its report, OMB also provided estimates of the costs and benefits of 34 final regulations that it reviewed from April 1, 1995, to March 31, 1998, for which it had relatively complete monetized estimates. These 34 rules represent about 25 percent of the "major" rules—rules that are expected to have an economic impact on the economy of over \$100 million—and about five percent of all the rules reviewed by OMB over this period.

The 34 rules are estimated to provide \$30 billion to almost \$100 billion in annualized benefits to society for about \$28 billion in annualized costs, suggesting net benefits even at the lower benefit estimate. Three rules dominate these estimates: a 1996 Health and Human Services rule that places restrictions on the sale of tobacco and the two 1997 EPA rules revising the National Ambient Air Quality Standards for ozone and particulate matter.

**Table 33-1. Estimates of the Total Annual Benefits and Costs of Social Regulations**

(In billions of 1996 dollars as of 1998, Q1)

	Benefits	Costs
Environmental .....	<sup>1</sup> 93 to 3,300	120 to 170
Transportation .....	84 to 110	15 to 18
Labor .....	28 to 30	18 to 19
Other .....	53 to 58	17 to 22
<b>Total</b> .....	<b>260 to 3,500</b>	<b>170 to 230</b>

Source: OMB, *Report to Congress On the Costs and Benefits of Federal Regulations, 1998*.

<sup>1</sup> The upper end of the range is based on an EPA report.

**Further Action:** The Government needs better data and analysis to determine whether proposed regulations maximize social benefits while minimizing cost. But agencies have legitimate reasons for their often incomplete estimates. In some cases, they face significant technical problems in assessing costs and benefits. In others, legal or judicial deadlines force the agencies to act within time frames that do not allow for adequate analysis. In still others, agencies may need to allocate their limited financial and human resources to higher priorities. Finally, in cases of emergencies, the public expects its elected leaders to respond without the delay that careful analysis would entail.

OMB is committed to improving the indicators to assess its performance in meeting the goal of ensuring that it is faithfully executing and managing regulatory policy. It will continue to lead an inter-agency effort to raise the quality of analyses that agencies use in developing regulations, such

as by offering technical outreach programs and training sessions on using OMB's "Best Practices" on economic analysis, and to make recommendations for better estimation techniques to value costs and benefits.

OMB also will:

- continue to develop a database on benefits and costs of major rules, using consistent assumptions and better estimation techniques to refine agency estimates of incremental costs and benefits; and
- work on developing appropriate methodologies to evaluate whether to reform or eliminate existing regulatory programs or their elements.

Regulation and regulatory reform can do much good for society, depending on whether the Government has the needed information and analysis for wise decision-making. The steps outlined above are designed to continue the Government's efforts to improve its ability to make better regulatory decisions.